CHAPTER 3

SELECTING CONTRACT TYPE

3-1. General

Many factors should be considered when selecting and/or negotiating the A-E contract type. They include the following:

a . Price analysis. Price analysis, with or without competition, may provide a basis for selecting the contract type. The degree to which price analysis can provide a realistic pricing standard should be carefully considered, even when there may not be full and open competition.

b. Cost analysis. In the absence of effective price competition and if price analysis is not sufficient, the contractor's proposal (cost estimate) and the Government estimate provide the bases for negotiating contract pricing arrangements.

c. Type and complexity of the requirement. Complex requirements, particularly those unique to the Government, usually result in greater risk assumption by the Government. This is especially true for complex research and development contracts, when performance uncertainties or the likelihood of changes make it difficult to estimate performance costs in advance.

d. Urgency of the requirement. If urgency is a primary factor, the Government may choose to assume a greater proportion of the risk or it may offer incentives to ensure timely contract performance. When the customer's or USACE's needs dictate an immediate contractor response to environmental or other problems requiring professional or technical work, contracts must contain advance agreements to meet those needs.

e. Period of performance. In times of economic uncertainty, contracts extending over a relatively long period may require economic price adjustment terms.

f. Adequacy of the contractors accounting system. Before agreeing on a contract type other than firm fixed price, it should be determined that the contractor's accounting system will permit timely development of all necessary cost data in the form required by the proposed contract type. This factor may be critical when the contract

type requires price revision while performance is in progress, or when a cost-reimbursement contract is being considered and all current or past experience with the contractor has been on a fixed-price basis.

g. Concurrent contracts. If performance under the proposed contract involves concurrent operations under other contracts, the impact of those contracts, including their pricing arrangements, should be considered.

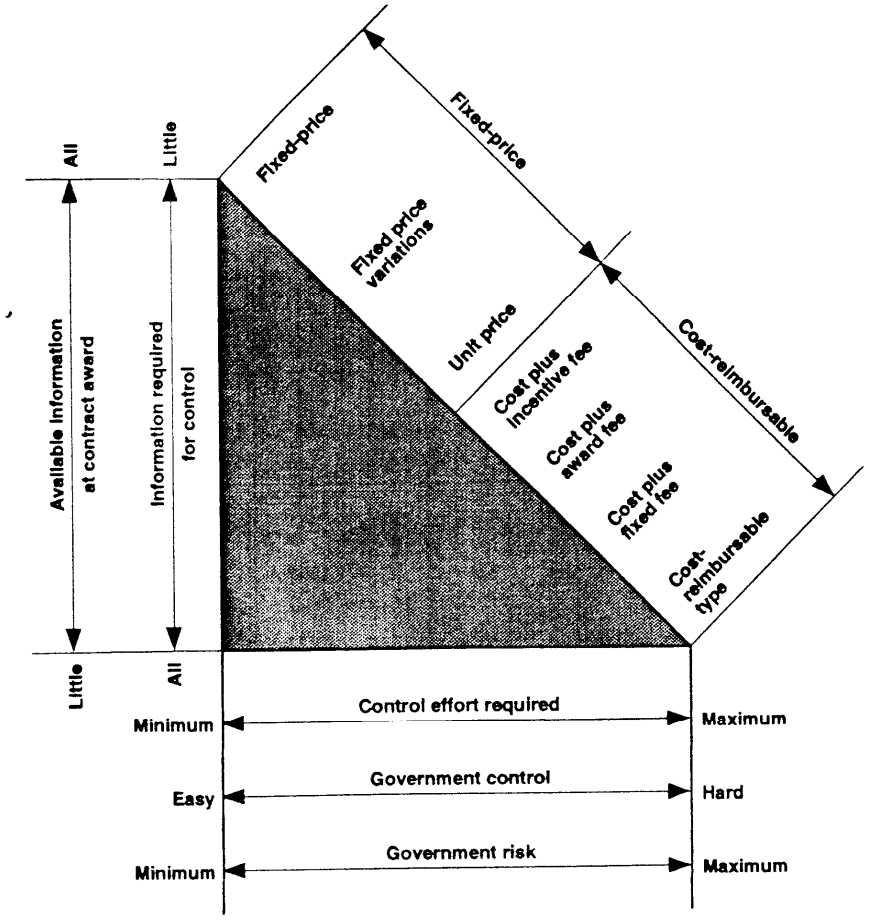
h. Extent and nature of proposed subcontracting. If the contractor proposes extensive subcontracting, a contract type reflecting the actual risks to the prime contractor should be selected.

3-2. Contract Selection Considerations

a. The primary considerations in contract selection is uncertainty, since risk (the other major factor cited above) is itself driven, in large part, by uncertainty. Risk can be associated with many aspects of a project such as time, personnel, cost, and work definition. Figure 3-1 shows the relationship of uncertainty and risk to various contract types. Notice that, as a rule, FFP contracts incur the least financial risk to the Government, while cost-reimbursement contracts incur the most. This is because in a fixed-price contract, financial risks with respect to the cost of the work are precisely defined. In a cost-reimbursement contract, this precise defining of the costs does not occur.

b. The selection of a contract type for a particular project is typically the result of an integrated effort involving two groups of people: those having technical expertise regarding the scope of the work and those familiar with the various types of contracts available to do the work. Expertise and knowledge from both those groups is essential in order to successfully address two major drivers of contract selection–uncertainty and risk. Issues pertaining to uncertainty are considered primarily by technical people who have the knowledge required to address specific project questions. Risk issues deal with controlling the costs associated with work to be done and are addressed by contracts people who have expertise in selecting contracts.

c. Environmental contracts now involve a third major consideration: the possible need for rapid response. This requirement dictates that advance agreements be in contracts in order to remove the necessity for time-consuming negotiations during critical phases of contract execution.



Source: "Impact on Risk Allocation and Equity in Construction Contracts," CTI Source Document 44, March 1989, The University of Texas at Austin, Austin, Texas, November 1988.

Figure 3-1. Factors Influencing Contract Choice

3-3. Risks Associated with Fixed-Price Contracts

With a fixed-price contract, the only risk to the Government is the work definition. The limitation of Government risk in fixed-price contracts is the reason for their being the preferred contract type. Unfortunately, the scope-of-work definition is sometimes poorly developed, resulting in numerous changes, increases in cost (including personnel costs), and delays. This highlights the fact that if the work definition, scope, design, and/or specifications are not sufficiently detailed, or are not presented clearly, a fixed-price contract is not the appropriate type. The work definition is a time-consuming task and requires the ability to define in writing the contract deliverables to be accomplished.

3-4. Risks Associated with Cost-Reimbursement Contracts

a. General. When considering a cost-reimbursement contract type, there are four major areas of risk to be considered: time, Government personnel, cost, and work

definition. The reasons for taking risks in these areas must be evaluated and prioritized so that the tradeoffs that are necessary can be used in selecting the contract type.

b. Time. In evaluating the time risk, the project manager must consider the time required to obtain approval to use a cost-reimbursement contract. Most offices where initial selection of contract type is performed do not have the authority to approve the use of a cost-reimbursement contract. The request to use this type of contract will generally require a written detailed justification and a determination and findings. Depending upon where the authority is maintained, it could take 30 to 90 days to obtain approval. This approval is a critical-path activity. On the other hand, cost-reimbursement contracting lends itself to fast-tracking or phased construction, thus greatly reducing the project duration, once approval has been gained.

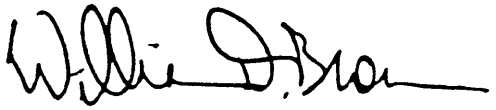
c. Government personnel. The Government personnel risk factor is difficult to quantify during the contract-type decision process. Administration of a cost-reimbursement contract can have a significant adverse impact on the administering office. Since the Government is assuming the cost risks associated with the contract, it must be prepared to assume an increased burden in administering the contract to minimize those risks. The activity could result in a substantial personnel drain on the administering office, depending upon the size and duration of the contract.

d. Cost. The cost risk factor in a cost-reimbursement contract is also difficult to quantify during the contract-type decision process. In actuality, the total cost of a cost-reimbursement contract is not known until the final audit of the contractor's records. The cost of awarding and administering the contract must also be considered, as noted above. The identification of the personnel requirements to administer a cost-reimbursement contract is a major element in determining the Government's cost. Also, there are cost risks related to the work definition. When the work definition is poor, the change orders will be many and large, with a corresponding increase in the cost risk factor.

e. Work definition. Work definition is a major factor affecting other risks. With good work definition, the time factor can be estimated, because it will be possible to identify which factors will require strenuous management to stay within the estimated

cost. Poor work definition could result in a contract that will require a full-time project manager or contract administrator. Poor work definition generally leads to contract changes and thus greater cost.

FOR THE COMMANDER:



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4 APPENDICES
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